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SENATE COMMITTEE ON ENERGY & ENVIRONMENT

TESTIMONY REGARDING THE JANUARY 31, 2008 AGENDA

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: JANUARY 31, 2008

TIME: 2:15PM

ROOM: 414

Contained in this testimony are the Department of Taxation (Department) comments on the Senate Committee on Energy & Environment's agenda for January 31, 2008. Because each measure relates to taxation, the Department's comments are in summary fashion for your convenience—

This legislation provides various tax incentives aimed at renewable energy and other alternative fuel related legislation.

I. THE DEPARTMENT SUPPORTS ENERGY REFORM POLICY.

The Department recognizes the importance of this legislation because these bills serve as another step in the right direction for minimizing Hawaii's dependence on fossil fuels. The Department and the administration both recognize the importance of Hawaii's energy independence and are in strong support of policies to that effect. The administration is committed to energy conservation and promoting alternative energy production, including reducing Hawaii's fuel dependency.

This legislation also compliments current federal incentives on the same subject matter.

II. DEFERRAL TO DBEDT ON THE MERITS.

The Department also defers to the Department of Business, Economic Development, & Tourism on the merits of this legislation. Though the Department is highly involved in the administration of these tax measures, the Department is not the subject matter expert on the viability of these policies and incentives.

III. SB 3215, RELATING TO BIODIESEL

This legislation, among other things, provides a real property exemption and an income tax exemption for biodiesel feedstock crop facilities.

Real Property Exemption

The Department has **no additional comments** on the real property exemption provided in this legislation, other than it will impact the county revenues.

Income Tax Exemption

The Department has **no additional comments** on this component.

Revenue Impact

This bill will result in an indeterminate revenue loss.

IV. SB 2766, RELATING TO ETHANOL

This legislation provides an income tax credit for installation of E-85 fueling facilities.

The Department **opposes** this legislation because it is underdeveloped and requires additional common requirements associated with other tax credits. Examples of this language can be provided upon request. Other similar bills in this agenda include the necessary language.

This legislation will result in the following revenue loss:

FY2010 (loss): \$198,000
FY2011 (loss): \$204,000

V. SB 2764, RELATING TO ETHANOL FACILITY TAX CREDIT

The Department has **no additional comments** on this legislation. However, the Department requests that the Committee be cognizant of its revenue impact because the 40 million gallon cap is eliminated.

This legislation will currently result in an indeterminate revenue estimate because the credit caps are blank.

VI. SB 2468, RELATING TO ETHANOL FACILITY TAX CREDIT

The Department has **no additional comments** on this legislation.

This legislation will result in a \$4 million gain.

VII. SB 2632 RELATING TO RENEWABLE ENERGY TECHNOLOGIES

This legislation amends the current Renewable Energy Technologies Income Tax Credit, by adding a new definition for "concentrating solar power energy systems." The Department **does not like this additional definition** and prefers that a definition in this credit focus on what is put into a machine rather than an approach based upon what the machine creates. In short, the Department prefers defining the technology based upon inputs; not outputs.

Based upon the Department's estimates, this legislation will not have an impact on the general fund.

VIII. SB 2623, RELATING TO RENEWABLE ENERGY TECHNOLOGIES

This legislation amends the current Renewable Energy Technologies Income Tax Credit, by adding a new definition for "solar electric energy systems." The Department **does not like this additional definition** and prefers that a definition in this credit focus on what is put into a machine rather than an approach based upon what the machine creates. In short, the Department prefers defining the technology based upon inputs; not outputs.

Based upon the Department's estimates, this legislation will not have an impact on the general fund.

IX. SB2744, RELATING TO HYDROGEN FUEL

The Department **opposes** this bill because of the numerous technical flaws outlined below.

Income Tax Credit

COMPLIANCE WITH RULES & STATUTES—The Department objects to this provision. The Department does not have the expertise or resources to ensure that any taxpayer claiming the credit is in compliance with all rules and regulations of whatever sort. For example, if a taxpayer obtains a speeding ticket or other citation, the taxpayer would be precluded from obtaining the credit as the bill is written. This section should be removed.

AMBIGUOUS CREDIT ACTIVITY—Currently the credit applies to "capital, operation, maintenance, or leasing costs related to the investments in hydrogen-powered vehicles and hydrogen fueling stations." The Department points out that it would be better to allow a credit for "costs" generally. Also, the Department suggests that the credit be narrowed to apply only to investments in the "development" of hydrogen fuel vehicles or fueling stations. This bill presupposes that such vehicles and stations exist, which they do not. The Department's comments should be taken into account to spur the activity that will result in the foregoing products.

ELIMINATE CAPS—This credit has caps in the aggregate. The Department strongly opposes caps because they are difficult to administer. There is no guidance. Should the caps be on a first-come-first-served basis? The caps should be eliminated in favor of a cap per taxpayer, which is

administrable.

DEFINITION OF "CORPORATION"—It would be unwise to define a corporation to include what are clearly partnership or pass through entities. Under well settled tax principles, a corporation is not a partnership and a partnership is not a corporation. However, a taxpayer may ELECT under current law to be taxed as a corporation. Better policy would be to defer to taxpayer desires and allow the taxpayer to control its own taxing status, rather than mandate it by statute.

TRANSFER OF CREDIT—The Department strongly opposes transferring any state tax credit. Transferring of credits turns otherwise good tax policy into tax shelters subject to abuse and fraud. Moreover, transferring credits makes administration difficult when it comes time to audit. One taxpayer claims the credit, when all of the facts relate to an unrelated taxpayer. The Department will be required to chase two different entities—one with the facts, the other with the money. The transfer of credits should be eliminated.

RECAPTURE—This credit lacks recapture provisions. The Committee should consider adding recapture provisions in order to ensure that if property is sold or disposed of the state is made whole by including in income the previously taken credit.

General Excise Tax Exemption

ELIMINATE CAPS—The Department does not support caps on credits or exemptions throughout the tax code. Caps on exemptions specifically are the most difficult to administer because there is no guidance provided in the statute for how to administer them. For example, is the exemption to be claimed on a first-come-first-served basis? Also, tax returns are filed periodically, which could likely result in going over the cap during a given period.

Revenue Impact

This bill will result in an indeterminate revenue loss.

X. SB 2455, RELATING TO RENEWABLE ENERGY TECHNOLOGIES

This legislation extends the current Renewable Energy Technologies Income Tax Credit to include hydrogen energy systems. There is no definition of the term "hydrogen energy system." The **Department requests that a definition be added** so that the Department can effectively administer this credit's extension.

This bill's revenue estimate is estimated to be minimal.

XI. SB 2932, RELATING TO ENVIRONMENTAL RESPONSE TAX

This bill increases the State Environmental Response Tax to \$0.25 per barrel of petroleum product. The bill also provides that an unspecified amount be used for concerns relating to drinking

water. The Department has **no comments** on this legislation.

The increased environmental response tax will increase the annual revenue of the Environmental Response Revolving Fund by approximately \$7.0 million dollars.

XII. SB 2032, RELATING TO INCOME TAX

This legislation increases the wind-powered Renewable Energy Technologies Income Tax Credit by various amounts. The Department has **no comments** on this legislation.

This legislation would result in a revenue loss of \$10,600 annually.

XIII. SB 2986, RELATING TO REFUNDABLE RENEWABLE ENERGY TAX CREDIT

This **Lingle-Aiona Administration measure** amends the Renewable Energy Technologies Income Tax Credit by allowing the credit to be refundable for those that have little Hawaii taxable income. The Department **strongly supports** this measure as a policy to encourage additional investment in renewable energy technologies.

Under current Hawaii law, pension income, including social security is not taxable. This population includes retirees that may have little Hawaii taxable income (investment income) due to the exclusion, but would otherwise have the resources to invest in these technologies. This legislation will allow those with the resources to obtain a refundable incentive for installations of renewable energy technologies. This legislation also extends to any taxpayer with less than \$20,000 of adjusted gross income. This would provide incentives for the lower- and middle-class to invest in these technologies.

Annual revenue loss is estimated to be \$41,000, starting in fiscal year 2009.

XIV. SB 3230, RELATING TO ENERGY

This legislation creates a Energy Security Tax assessed on a per-barrel of petroleum product basis, as well as a special fund to administer the revenue.

The Department of Taxation has **no additional comments** on this legislation other than it is a tax increase that will eventually impact the gasoline prices all Hawaii drivers pay and creates an unnecessary special fund.

XV. SB 2943, RELATING TO ENERGY

This legislation increases the Renewable Energy Technology Income Tax Credit amounts to various amounts. This legislation also includes wave energy as a qualifying energy technology. The Department has **no additional comments** on this legislation.

This legislation will result in a revenue loss of approximately \$400,000 for FY 2009 and \$1.2 million for FY 2010.

XVI. SB 2946, RELATING TO RENEWABLE ENERGY OPPORTUNITY ZONES

This legislation creates Renewable Energy Opportunity Zones that, among other things, provide taxpayers within the zones with tax incentives similar to that of current Enterprise Zones.

The Department of Taxation **supports the intent** of this measure because it is an intuitive, logical, and bold step in the right direction for supporting Hawaii energy independence. The Department, as a co-participant of the Enterprise Zone system, agrees that these systems have worked to attract businesses to high-risk areas that need economic stimulus. This legislation will provide businesses with the opportunity to join other similar businesses geographically in order to consolidate the talent and resources of alternative energy research and development into one opportunity zone. The Department also points out that similar "opportunity zone" legislation has been very successful on the federal level with the Liberty Zone in New York and the Gulf Opportunity Zones in the south.

This legislation will result in a revenue loss of approximately \$1 million per year.



**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT & TOURISM**

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Statement of
THEODORE E. LIU
Director

Department of Business, Economic Development, and Tourism
before the

**SENATE COMMITTEE ON
ENERGY AND ENVIRONMENT**

Thursday, January 31, 2008
2:15 PM

State Capitol, Conference Room 414

in consideration of
SB 2764

RELATING TO ETHANOL FACILITY TAX CREDIT.

Chair Menor, Vice Chair Hooser, and Members of the Committee.

The Department of Business, Economic Development, and Tourism (DBEDT) appreciates the over-all concept of this bill as it includes initiatives supportive of our goals and objectives, but we are concerned about the cost implications generated by this proposal.

We defer to the Department of Taxation on tax implications and administration.

SB 2764 would repeal the qualifying capacity limits and the cap on the annual amount of tax credits.

We agree that more flexibility in the size of a facility would be desirable, but are concerned about completely repealing the cap on credits allowed for each facility or for the maximum aggregate annual credits payable.

We recommend the following changes:

Beginning on page 2, line 1, revise to read:

eight-year period shall be equal to thirty per cent of its nameplate capacity, [~~if the nameplate capacity is greater than five hundred thousand but less than~~] up to the first fifteen million gallons. A taxpayer may claim this credit for each qualifying ethanol facility; provided that:

We do not support the change on Page 6, but concur with the change proposed on page 7.

These changes would allow both large and small facilities to receive the same tax credit for their first 15 million gallons per year of production capacity, without exposing the State treasury to an unknown level of liability.

Encouraging the local production of renewable fuels is consistent with Hawaii's energy objectives and supportive of Hawaii's renewable energy future.

Thank you for the opportunity to offer these comments.

**SB 2764
RELATING TO ETHANOL FACILITY TAX CREDIT**

**PAUL T. OSHIRO
MANAGER – GOVERNMENT RELATIONS
ALEXANDER & BALDWIN, INC.**

JANUARY 31, 2008

Chair Menor and Members of the Senate Committee on Energy & Environment:

I am Paul Oshiro, testifying on behalf of Alexander & Baldwin, Inc. (A&B) and Hawaiian Commercial & Sugar Company, one of its agricultural companies, on SB 2764, "A BILL FOR AN ACT RELATING TO ETHANOL FACILITY TAX CREDIT." We support this bill.

As one of two remaining sugar companies operating in the State, Hawaiian Commercial & Sugar Company (HC&S) celebrated its 125th anniversary in 2007. While Hawaii's many other sugar companies have shut down over the years, HC&S has been fortunate, through significant investments by our parent company, A&B, in our agricultural infrastructure and operations and the implementation of our diversified bio-production program, to have sustained our operations and continue as a major employer in the State of Hawaii. Today, as we face the prospect of lower margins from raw sugar production because of flat commodity prices along with increasing production costs, HC&S is in the process of transitioning from a primary producer of commodity sugar into the production of specialty sugar and bio-based products. In addition to being the sole supplier of Sugar In The Raw, the little brown packets of sugar seen at restaurants and coffee shops across the nation, HC&S is also expanding production of

our specialty Maui Brand Sugar. HC&S also produces several bio-based products, and provides Maui Electric with biomass produced electricity.

HC&S is also actively and seriously evaluating the feasibility of becoming a producer of ethanol. Our initial investigation into a production facility that would convert only our final molasses to ethanol found, after much research and analysis, that a plant of this scale would not be financially feasible. HC&S is now presently analyzing a larger ethanol production facility that would convert not only all of our molasses, but a significant portion of our cane juice as well. The fermentation process we are focused on is a proven, practical method, similar to how Brazil presently produces ethanol. The sugar cane plant provides many advantages over other crops with respect to energy output because of its efficiency in converting sunlight into biomass energy. However, the required investment in building an ethanol facility is significant and the risks, because of fluctuating energy prices, is also significant.

The ethanol facility tax credit is an important component in HC&S's determination of the financial feasibility of our ethanol production initiative that is presently under consideration. This bill would serve to support the potential of an ethanol industry in Hawaii and at HC&S by repealing the qualifying capacity limits of ethanol production facilities and the sunset provision with respect to the total annual nameplate capacity for qualifying ethanol production facilities. This is particularly important for HC&S, and likely for other prospective producers, because economies of scale can improve significantly on a facility above 15 million gallons.

Based on the aforementioned, we respectfully request your favorable consideration on this bill.

Thank you for the opportunity to testify.

L E G I S L A T I V E

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SUBJECT: INCOME, Ethanol facility tax credit

BILL NUMBER: SB 2764; HB 2312 (Identical); SB 2468; HB 2595 (Identical)

INTRODUCED BY: SB 2764 by Tsutsui; HB 2312 by Caldwell and 1 Democrat; SB 2468 by Tokuda; HB 2595 by Chong, Lee, B. Oshiro, M. Oshiro, Say, Tsuji, Yamane, Yamashita, and 1 Democrat

BRIEF SUMMARY: SB 2764/HB 2312 amends HRS section 235-110.3 to repeal the annual 15 million gallon capacity limit in order to claim the ethanol facility tax credit. Deletes the amount of the credit limitations to provide that if the annual amount of certified credits reaches \$_____, the department of business, economic development and tourism (DBEDT) shall discontinue certifying credits and notify the department of taxation. Further stipulates that in no instance shall the total amount of certified credits exceed \$_____ per year. Repeals the provisions prohibiting the issuance of the credits when ethanol production reaches 40 million gallons per year.

SB 2468/HB 2595 reduces the total amount of ethanol facility tax credits that may be issued between July 1, 2008 and December 31, 2012 from \$12 million to \$8 million. This measure shall be applicable to tax years beginning after December 31, 2007 and ending before January 1, 2013.

EFFECTIVE DATE: SB 2764/HB 2312 - January 1, 2009; SB 2468/HB 2595 - Tax years beginning after December 31, 2007

STAFF COMMENTS: The legislature by Act 289, SLH 2000, established an investment tax credit to encourage the construction of an ethanol production facility in the state. The legislature by Act 140, SLH 2004, changed the credit from an investment tax credit to a facility tax credit.

It is curious that while SB 2764/HB 2312 proposes to repeal the nameplate capacity limits in order to claim the credit to encourage the large-capacity production of ethanol, SB 2468/HB 2595 proposes to reduce the total amount of credits that may be issued from \$12 million to \$8 million.

While these measures would perpetuate the tax incentives for the construction and development of an ethanol production facility in the state, it should be remembered that a direct appropriation would be preferable. This would provide some accountability for the taxpayers' funds being utilized to support this effort. However, the more important point to note here is the arduous path to success for this proposal with the initial tax incentive adopted in 2000 and here some eight years later, the interested parties have yet to put the first spade in the ground. Meanwhile the administration in its great wisdom has mandated the use of 10% ethanol in motor vehicles, resulting in the import of ethanol to meet the needs of the state.

The purpose clause of SB 2468/HB 2595 indicates that the amount of the ethanol credit is being reduced so that funding needs of other agricultural concerns in the state can be met. What those concerns are is

SB 2764; HB 2312; SB 2468; HB 2595 - Continued

not clear. However, it does highlight the fact that tax credits do not necessarily translate into the desired outcomes. What it does mean is that the anticipated loss of revenues reduces the potential to spend these funds on other programs or projects which are also deemed of a high priority.

More than likely the proponents of the ethanol facility have encountered the bureaucratic maze that is so familiar to businesses in Hawaii and thus have been delayed. If lawmakers truly would like to get the ethanol facility up and running to provide Hawaii motorists with an alternative source of ethanol and create the jobs the ethanol facility was touted to create, then they should look into what has held up progress on the building of the facility and address those issues separately.

Digested 1/30/08